Supreme Court, U. S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1974

No. 74-1521

COVINGTON FABRICS CORP., APPELLANT,

versus

SOUTH CAROLINA TAX COMMISSION, APPELLEE

ON APPEAL FROM THE SOUTH CAROLINA SUPREME COURT

JURISDICTIONAL STATEMENT

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COVINGTON FABRICS CORP., APPELLANT,

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SOUTH CAROLINA TAX COMMISSION, APPELLEE

ON APPEAL FROM THE SOUTH CAROLINA SUPREME COURT

JURISDICTIONAL STATEMENT

INTRODUCTORY PARAGRAPH

Appellant appeals from the judgment of the Supreme Court of the State of South Carolina filed on March 10, 1975, affirming an Order of the Court of Common Pleas which held that Appellant was liable for South Carolina additional corporate income taxes and corporate license fees. This statement is submitted to show that the Supreme Court of the United States has jurisdiction of the appeal and that substantial questions are presented.

OPINION BELOW

The Supreme Court of South Carolina filed a written opinion, which is not yet officially reported, but is unofficially reported at 212 S. E. (2d) 574, the text of which is set out in Appendix A, *infra,* at page 17. The Court of Common Pleas Order, which is unreported, is set out in Appendix B, *infra,* at page 24. Report of Master in Equity, which is unreported, is set out *infra* as Appendix C, at page 30.

JURISDICTION

The decision from which this appeal is taken is the final judgment of the highest Court of the State of South Carolina. Jurisdiction of this Court is invoked pursuant to 28 U. S. C. 1257(2). This appeal draws into question the applicability of South Carolina Code of Laws of 1962, as amended, § 65-222.2, § 65-279.6, § 65-602, and § 606 on the ground that as applied they are repugnant to the U. S. Constitution and *contra* to Federal law.

On December 23, 1969, Appellant, doing a multi-state business, paid South Carolina corporate income taxes and corporate license fees (dependent upon income tax liability) assessed by Appellee for the years 1964 through 1968 and timely brought suit to recover the same. Appellant contended that the allocation of sales to it by the Appellee did not bear a reasonable relation to the proportion of trade or business carried on in or to the benefits conferred by the State of South Carolina; that there was an undue burden on interstate commerce in violation of Article 1, Section 8, of the Constitution of the United States, in violation of Section 1 of the Fourteenth Amendment to the Constitution of the United States in that it was a taking without due process of law, and the extent of activity of Appellant in the states of the purchasers of its goods removed the protection of Federal law, to wit, Public Law 86-272 (15

U. S. C., § 381) so as to cause sales to be "taxable" in the state of the purchaser rather than to be claimed as sales by Appellee. In its Opinion filed March 10, 1975, the Supreme Court of South Carolina held that the taxes and license fees allocated by Appellee did not violate the Commerce Clause or the Fourteenth Amendment to the U. S. Constitution and failed to consider evidence showing activity in states of the purchasers to be beyond the protection of Public Law 86-272 (15 U. S. C., § 381) so as to make sales claimed by Appellee "taxable" in those states of the purchasers.

This Court has jurisdiction where a state court holds a state statute to be applicable in face of a contention that such application is invalid on federal grounds. *Bantam Books, Inc. v. Sullivan,* 372 U. S. 58, 83 S. Ct. 631 (1963); *Central R. R. of Pennsylvania v. Commonwealth of Pennsylvania,* 370 U. S. 607, 82 S. Ct. 1297, and *Dahnke-Walker Milling Co. v. Bondurant,* 257 U. S. 282.

In the event that the Court does not consider appeal the proper mode of review, Appellant requests that the papers upon which appeal is taken be regarded and acted upon as a Petition for Writ of Certiorari, pursuant to 28 U. S. C., § 2103.

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

1. The Commerce Clause of the United States Constitution set out in Appendix D hereto.

2. Section 1 of the Fourteenth Amendment to the United States Constitution set out in Appendix E hereto.

3. 15 U. S. C. § 381 (Public Law 86-272) set out in Appendix F hereto.

4. South Carolina Code of Laws (1962) §§ 65-222.2, 65-279(6), 65-602 and 65-606 (the South Carolina corporate

income and license tax provisions) set out in Appendix G hereto.

QUESTIONS PRESENTED

I. In view of the fact that Public Law 86-272 (15 U. S. C. 381) only restricts a state in imposing a tax on net income of a unitary business where the only contact with the taxing state is the mere solicitation of orders therein, can Appellee apportion to itself sales of Appellant's products in states of the purchasers when the uncontradicted evidence shows that the activities of Appellant in such states exceed mere solicitation of orders?

II. Where the activity of Appellant in South Carolina in the mere maintenance of a rented warehouse where its goods are temporarily kept awaiting shipping orders, and, where sales to S. C. customers are only slightly over 1% of all sales, is it just, fair, reasonable or constitutional for Appellee to claim an apportionment made up of 70% of all property, 20% of all payrolls and 84% of all sales, or a total of 55.5% of all Appellant's entire income?

III. Since the decision of *N. W. States Portland Cement Co. v. State of Minn.*, 358 U. S. 450, 79 S. Ct. 357, is it no longer required that the apportionment of income bear a direct relation to the income producing activities, that the portion of the net income taxed arise from those income producing activities, and bear a direct relation to the protection and opportunities afforded by the taxing state?

STATEMENT

A. Material Facts.

The Appellant, Covington Fabrics Corp., is a New York corporation with its headquarters in New York City. It purchases griege goods (raw materials) from abroad and from suppliers in the United States. These raw materials are shipped to one of three completely independent

cleaning and finishing plants to clean and to convert into slipcovers, draperies and upholstery fabrics. One such plant to which a fee is paid by Appellant for the service of cleaning and converting is located in South Carolina, one in Massachusetts, and the third in North Carolina. These fee-paid, independent cleaners and converters ship the converted goods to Appellant's rented warehouse located at McColl, South Carolina to be retained there awaiting shipping orders from Appellant's headquarters in New York. Appellant's rented warehouse manager and a crew of laborers at McColl, S. C. pack and ship the goods as per New York instructions to purchasers in all fifty states and abroad. Appellant owns no manufacturing plant in South Carolina, has no sales offices here, no showroom, and no executive nor administrative personnel here. The salesman who services South Carolina comes in twice per year for a total of four days per year. All planning, design, pricing, billing, management, inventory and record keeping are done in New York. Appellant maintains sales office, showrooms and a merchandise mart in Chicago and Los Angeles. Sales of Appellant's goods to South Carolina customers are minimal, there being only slightly over one per cent of total sales to South Carolina customers. Appellant's salesmen when they come into a state, in addition to soliciting orders, also have the duty to collect and service delinquent accounts.

Appellant allocated to South Carolina 70% of all property, 20% of all payrolls, and slightly over 1% of all sales. Appellant voluntarily paid to Appellee corporate income taxes and corporate license fees based on the aforesaid allocation, thus allocating to Appellee some 29% of Appellant's entire income. Appellant actually paid taxes on its income to New York and California in addition to South Carolina.

Appellee assessed additional income taxes and corporate license fees, accepting the 70% allocation of all property, the 20% allocation of all payrolls, but raised the sales allocation to 84% of all sales, accomplishing this by claiming sales made to purchasers in other states where those states had not "taxed," asserting that those sales were not "taxable" in the state of the purchaser, and, therefore, were sales which Appellee could claim under South Carolina Code of Laws (1962) §§ 65-279(6) and 65-222.2, Appendix G hereto. After laying claims to such sales, Appellee had allocated to itself 55.5% of Appellant's entire income.

B. Stage at which Federal Questions Raised.

When Appellee gave notice of the proposed additional taxes and license fees, the Federal questions were raised by Appellant. They were raised in the pleadings filed in the Court of Common Pleas. They continued to be raised in the hearings before the Master in Equity of Richland County to whom the Judge of the Court of Common Pleas referred the matter, whose Report is set out, *infra,* as Appendix C, in Exceptions taken to that Report, in the Court of Common Pleas on the Exceptions to the Master's Report and before the Supreme Court of South Carolina, where the Federal constitutional questions were briefed and argued, as well as the matter of the misapplication of Public Law 86-272 (15 U. S. C. 381). The Supreme Court of South Carolina stated "* * * the application of the three factor formula does not produce a result that is in conflict with the Constitutional provisions referred to nor does the application of the formula depart from the requirement of Section 65-222.2 of the Code."

The said Court further stated with reference to Public Law 86-272 (15 U. S. C. 381): "This act of Congress requires minimum contact and activity within a state by a foreign corporation before its income can be taxed by the

state and therefore inferentially, if not directly, limits the application of the sales factor found in Section 65-279.6. Such is not relevant in this action however because the evidence supports one conclusion, that being that the corporation in these periods was taxable only in three states: New York, California and South Carolina." Appendix G, *infra,* page 43.

The appellant took the position that the additional income taxes and corporate license fees were unconstitutionally assessed and collected and that the activities of Appellant in states of the purchasers of Appellant's goods supported a tax, that the income was "taxable" there because of the testimony that showed activity in excess of the protected minimum activity, that the criterion was not whether such income "had been taxed" but rather whether in light of Public Law 86-272 (15 U. S. C. 381) such income was "taxable" in the state of the purchaser.

THE QUESTIONS ARE SUBSTANTIAL

The opinion of the South Carolina Supreme Court being appealed sanctions the assessing and collecting of corporate income taxes and license fees from a foreign corporation engaged in a unitary or multistate business by including, in the sales factor of its three factor formula, sales of goods shipped from Appellant's rented warehouse in South Carolina to purchasers in other states, where the uncontradicted testimony was that the extent of the activity of Appellant's salesmen in all states where its goods were sold (being all fifty states) exceeded the minimum *nexus* or contact protected by 15 U. S. C. 381 (Public Law 86-272). By so sanctioning the Supreme Court of South Carolina has ignored the matter of whether such sales were "taxable" and has merely determined that if such sales were not, in fact, "taxed" in the state of the purchaser, then such sales were not "taxable" in such states and, thus, despite

minimal sales in South Carolina, Appellee can pad its apportionment of sales by picking up all sales where they were not "taxed" in the state of the purchaser. The decision of the South Carolina Supreme Court on this point, that is, in its interpretation and application of Federal law, 15 U. S. C. § 381 (Public Law 86-272), is in direct conflict with decisions of the highest court of Oregon in *Herff Jones Co. v. State Tax Commission* (Oregon, 1967), 430 P. (2d) 998, and the highest court of Arkansas in *Hervey v. A. M. F. Beaird* (Ark. 1971), 464 S. W. (2d) 557, both of which courts gave a narrow construction to Public Law 86-272 (15 U. S. C. § 381), and holding that its purpose was to restrict the right to tax only in cases involving contact with such state to merely solicit orders, and that activity beyond that in such state rendered the taxpayer "taxable" therein. Equally involved and equally substantial is the Federal question whether with its contact with South Carolina the mere maintenance of a rented warehouse to which its goods are temporarily sent awaiting instructions from Appellant's headquarters in New York, a function formerly handled by "drop shipments" on the part of independent cleaners and converters, it is unconstitutional to exact, as Appellee's proper share, a tax based on 70% of property, 20% of payroll and 84% of sales in that such allocation is a taking of property without due process of law and an undue burden on interstate commerce. There are substantial Federal questions in light of decisions of this Court in *Norfolk and Western Railway Co. v. North Carolina,* 297 U. S. 682, 56 S. Ct. 625, holding that a formula which is not arbitrary or unconstitutional on its face, or in general application, might be unfair and unreasonable when applied to a particular state of facts. Appellant has contended that the sales factor formula, as applied, in that it encompasses "sales" that were "taxable" in the state of the purchaser

of Appellant's goods, has resulted in a taking of property without due process and an undue burden on interstate commerce. These are substantial questions.

I. South Carolina cannot apportion to itself sales of Appellant to purchasers in other states where the activity (contact) of Appellant in those states exceed the mere solicitation of orders.

If the decision of the Supreme Court of South Carolina is correct and allowed to stand, then, it means that whether or not the activity of such multi-state unitary business in South Carolina is minimal, as here, nevertheless, even in the maintenance of a rented warehouse, in which its goods are temporarily housed awaiting sales orders from outside South Carolina, Appellee can justify an unconstitutional allocation by examining to see in how many states of purchasers income has been "taxed" and claiming as its own, untaxed income. Such a situation does not insure fair, reasonable and constitutional apportionment, but, to the contrary, fosters a means whereby the exaction by Appellee has no reasonable relation to the activity in or the extent of protection and opportunities afforded by maintenance of a rented warehouse in South Carolina. It is the intent of Public Law 86-272 (15 U. S. C. § 381) that if activity or contact by a corporation engaged in interstate commerce in a particular state is beyond the mere solicitation of orders therein, then, the protection against that state's asserting a tax on income is lost and the income is "taxable" in that state. A decision by this Court settling this issue is imperative.

Several states through decisions of their highest courts, *supra,* have held that protection against taxation provided by Public Law 86-272 (15 U. S. C. § 381) is lost when something more is done than to merely solicit orders

by incoming salesmen in a state by one engaged in interstate commerce.

In enacting Public Law 86-272 Congress intended to free interstate commerce from compliance with diverse, dissimilar, inconsistent and overlapping state income tax laws. [S. Rep. No. 658, 86th Congress, 1st Session, 2-5 (1959).] To get that result proper and uniform interpretation thereof is paramount.

Appellant produced testimony, which was uncontradicted, that the activity of its salesmen coming into the 50 states in which sales were made exceeded the mere solicitation of orders. (Tr. ff. 225, 241-243.) They regularly engaged in collecting and serving delinquent accounts.

II. Where the activity of Appellant in South Carolina is the maintenance of a rented warehouse and where sales to South Carolina customers are only slightly over 1% of all sales, it is not fair, just, reasonable or constitutional to demand an allocation of 70% of all property, 20% of all payroll, and 84% of all sales.

Appellant produced testimony, which was uncontradicted, that the rented warehouse at McColl, S. C. represents no capital investment [Tr. ff. 455-457] and that this only contact with South Carolina (the rented warehouse) could be abandoned promptly with no disruption to its business [Tr. ff. 469-471]. This demonstrates conclusively the lack of any real part that this rented warehouse plays in the production of income and also points out the minimum protection and opportunities afforded Appellant by South Carolina.

This Court has made numbers of decisions in cases dealing with the right of a state to tax income of a business the components of which are carried on in several states. Those decisions uniformly sanction a tax on net income provided the tax bears a reasonable relation to the activity

of the interstate business within the taxing state. At the same time this Court has uniformly held that in the absence of such logical and reasonable reference to the production of income within the taxing state, then it comes into conflict with the Fourteenth Amendment. *Maxwell v. Kent-Coffey Mfg. Co.*, 204 N. C. 365, 168 S. E. 397, aff. 54 S. Ct. 437.

In *Ott v. Mississippi Valley Barge Line*, 366 U. S. 169, 69 S. Ct. 432, it was held that the tax in its practical operation must be related to the opportunities, benefits and protection afforded by the taxing state and that requirement is satisfied if the tax is fairly apportioned to the commerce carried on within the state. It goes without saying that this taxpayer's being able to abandon all taxable contact with South Carolina with no disruption of business there cannot possibly be any opportunities, benefits and protection afforded by South Carolina justifying an apportionment made up of 70% of all property, 20% of all payroll and 84% of all sales.

III. This Court in N. W. States Portland Cement Co. v. State of Minn., 358 U. S. 450, 79 S. Ct. 357, a landmark decision in area of taxation of interstate operations, specifically left open the matter of fairness of apportionment, stating that issue not involved.

Following this decision, Congress passed Public Law 86-272 (15 U. S. C. 381) to specifically protect a foreign corporation from state taxation of its interstate income where the only contact with such state was the visitation therein by taxpayer's salesmen to solicit orders. However, in the said decision itself, without regard to the later enactment, this Court implicitly recognized that the bare right to taxation and the fairness of the exaction were two entirely different things. The Court stated "where taxes imposed by a state on the income of a foreign corporation are

levied only on that portion of the corporation's net income which arises from its activities within the taxing state, and the corporation engages in substantial income-producing activity in the taxing state, imposition of the tax does not contravene the Due Process Clause of the Federal Constitution."

Appellant has shown by direct evidence that it did not engage in substantial income-producing activity in South Carolina, and that to tax 84% of all its sales is to tax far beyond that portion of its net income arising from its activities (the renting of a warehouse in which its goods are temporarily kept) within South Carolina.

The decision of the South Carolina Supreme Court, Appendix A, *infra*, herein, carries the decision of this Court in *N. W. Portland Cement Co. v. State of Minn.*, 358 U. S. 450, 79 S. Ct. 357, a case dealing with *nexus*, the bare right to tax, far beyond that point to the point of the fairness of the apportionment, and must be construed to mean that any contact, however small, justifies an apportionment to Appellee of 55.5% of Appellant's entire net income.

In *N. W. Portland Cement, supra*, this Court carefully pointed out that the reasonableness of the apportionment of net income was not involved.[1] The fairness of the formula is the sole issue raised throughout by Appellant here.

Research has failed to disclose any case decided by the Supreme Court of South Carolina involving the fairness of the specific there factor formula as applied to an interstate business.

There have been several decisions by that Court involving which formula, that is, a two factor formula or a three factor formula, was the proper of two available formulae in terms of the nature of the taxpayer's business.

[1] At page 359 of the reported case, it is stated "No question is raised in either case as to the reasonableness of the apportionment of net income under the State's formulas nor to the amount of the final assessment made."

Additionally, research has failed to disclose any decision where the proven activity was so minimal and the exaction, in turn, so extremely unreasonable.

This Court has recognized that where activities within a taxing state do not have a real and substantial relation to the business transacted therein, there are resulting constitutional violations, and, in *Wisconsin v. J. C. Penney Co.*, 311 U. S. 435, 61 S. Ct. 246, the Court stated that "Attempted transgressions of these limits of state sovereignty have time and time again run afoul of the Fourteenth Amendment." Here, there is a positive showing by Appellant that Appellee has overstepped those limits.

CONCLUSION

For the foregoing reasons, this Court should note probable jurisdiction and reverse the judgment below.

Respectfully submitted,

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APPENDIX

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APPENDIX A

The State of South Carolina
IN THE SUPREME COURT

COVINGTON FABRICS CORP., APPELLANT,

versus

SOUTH CAROLINA TAX COMMISSION, RESPONDENT

APPEAL FROM RICHLAND COUNTY, JOHN GRIMBALL, JUDGE

OPINION NO. 19968
Filed March 10, 1975

AFFIRMED

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MOSS, C. J.: Covington Fabrics Corporation, the Appellant herein, brought this action against the South Carolina Tax Commission, the Respondent herein, pursuant to Sections 65-2661 and 65-2662, Code of 1962, as amended, to recover the sum of $36,227.32, together with interest

thereon, being additional corporate income taxes and corporate license fees assessed by the Respondent against the Appellant. The taxes so assessed were paid under protest on December 23, 1969.

The Respondent, by way of answer, alleged that the additional income taxes and corporate license fees were properly assessed pursuant to the sales factor contained in the tax apportionment formula. Sections 65-279.3 through 65-279.6 of the Code.

This case was referred to the Master in Equity for Richland County, and he was directed to take the testimony and to report his findings of fact and conclusions of law. The Master recommended that the claim of the Appellant be denied. The Appellant filed numerous exceptions to the Master's Report, and these were heard by the Honorable John Grimball, Resident Judge, who, by his order of January 12, 1974, confirmed the Report of the Master. This appeal followed.

The questions to be decided in this case are whether the Respondent properly applied the sales factor of the apportionment formula contained in Sections 65-279.3 through 65-279.6 of the Code and, if such formula was correctly applied, did it produce an unconstitutional result.

The Appellant, a corporation existing under the laws of the State of New York, engages in a unitary business both within and without this State and is therefore subject to income and corporate license taxation by this State.

Income tax returns for the tax period ending May 31, 1967, through May 31, 1969, inclusive, were filed by the corporation, and a tax was paid on net income that had been apportioned by use of a three factor formula consisting of the average of the percentages of property in this State to all property, payroll in this State to all payrolls and sales in this State to all sales. The corporation, in the use of the sales factor, allocated slightly more than one (1%) percent of total sales to South Carolina, those being sales delivered to South Carolina customers. The Tax Commission, on audit, however, allocated to this State all sales shipped from South Carolina into other states in which the

corporation was not subject to taxation, which resulted in assessments for additional income taxes and interest in the amount of $36,227.32 and corporate license taxes and interest in the amount of $480.78. The tax periods for corporate license taxes were those that ended May 31, 1966, May 31, 1967, and May 31, 1968, and the amount of the additional assessment was also ascertained by use of the three factor formula.

Of the three factors used in the formula to determine the corporation's net income and license base subject to taxation by this State, only the sales factor is involved in this action. Section 65-279.3 provides for the use of the three factor formula for this class of business and Section 65-279.6, the sales factor, is as follows:

> "The ratio of sales made by such taxpayer during the income year which are attributable to this State to the total sales made by such taxpayer everywhere during the income year, and for purposes of this article, sales attributable to this State shall be all sales where the goods, merchandise, or property is received in this State by a purchaser, other than the United States Government. In the case of delivery of goods by common carrier, or by other means of transportation, including transportation by the purchaser, the place at which the goods are ultimately received after all transportation has been completed shall be considered as the place at which the goods are received by the purchaser. Direct delivery into this State by the taxpayer to a person or firm designated by a purchaser from within or without the State shall constitute delivery to the purchaser in this State. **Sales are attributable to this State when the property is shipped from within this State** and the purchaser is the United States Government or **the taxpayer is not taxable in the state of the purchaser**. The word 'sales' as used in this article shall be construed to include rentals of tangible personal property the rentals from which are not separately allocated under this article. Such rentals to be attributed to this State if the property is located in this State. Sales of intangible personal property shall

be attributable to this State if the entire income producing activity is within this State, or based on costs of performance the greater proportion thereof is performed within this State." (Emphasis added.)

The underscored language creates the subject of this action because under such these sales are allocated to this State. The Appellant contends, however, that the allocation resulted in an unconstitutional tax prohibited by the Commerce Clause of the Constitution of the United States (Article 1, Section 8); the due process clauses of the Constitution of the United States (Section 1 of the Fourteenth Amendment), and the Constitution of South Carolina (Article 1, Section 5), and Section 65-222.2 of the South Carolina Code of Laws which levies the tax upon a base that reasonably represents the proportion of the corporation's business carried on within this State. With such contention, we however, must disagree.

It is well settled that a state has a right to impose a tax on apportioned income derived from business conducted partly within and without the state.

"* * * it has been established since 1918 that a net income on revenue derived from interstate commerce does not offend constitutional limitations upon state interference with such commerce. The decision of *Peck & Co. v. Lowe,* 247 U. S. 165, 38 S. Ct. 432, 62 L. Ed. 1049, pointed the way." *Portland Cement Co. v. Minnesota,* 358 U. S. 450, 79 S. Ct. 357, 3 L. Ed. (2d) 421, 67 A. L. R. (2d) 1292. See also *Underwood Typewriter Co. v. Chamberlin,* 254 U. S. 113, 41 S. Ct. 45, 65 L. Ed. 165.

Such also has long been recognized by this Court. *Western Union Telegraph Co. v. Query,* 144 S. C. 234, 142 S. E. 509. We there upheld the right to tax net income arising from interstate operations within the State. In the case of *Santee Mills v. Query,* 122 S. C. 158, 115 S. E. 202, we held that:

"The right of a state to levy an income tax upon income derived by nonresidents from property within

the State or from business carried on within the State is settled in the affirmative by the recent decisions of the Supreme Court of the United States in *Shaffer v. Carter,* 252 U. S. 37, 40 S. Ct. 221, 64 L. Ed. 445 and *Travis v. Yale & Towne Mfg. Co.,* 252 U. S. 60, 40 S. Ct. 228, 64 L. Ed. 46." For other cases and comments, see 90 A. L. R. 484 and 67 A. L. R. 1322.

The only change in this area of taxation is that provided by Federal law found in 15 U. S. C. A. 381. This act of Congress requires minimum contact and activity within a state by a foreign corporation before its income can be taxed by the state and therefore inferentially, if not directly, limits the application of the sales factor found in Section 65-279.6. Such is not relevant in this action however because the evidence supports one conclusion, that being that the corporation in these periods was taxable only in three states; New York, California and South Carolina.

The corporation must establish its contention that the statutes impose an unconstitutional tax by "clear and cogent evidence."

"One who attacks a formula of apportionment carries a distinct burden of showing by 'clear and cogent evidence' that it results in extraterritorial values being taxed. See *Norfolk & Western Ry. Co. v. North Carolina,* 297 U. S. 682, 688, 56 S. Ct. 625, 628, 80 L. Ed. 977." *Butler Bros. v. McColgan,* 315 U. S. 501, 62 S. Ct. 701, 86 L. Ed. 991. See also *State Ex Rel. Maxwell v. Kent Coffey Manufacturing Co.,* 204 N. C. 365, 168 S. E. 397, 90 A. L. R. 476, affd. *per curiam* 291 U. S. 642, 54 S. Ct. 437, 28 L. Ed. 1040.

The obvious purpose of the apportionment formula is the determination of income from business activities within this State and is a proper subject for legislative action. *State Ex Rel. Maxwell v. Kent Coffey Manufacturing Co., supra.*

Although exactness in apportionment is desirable, all that is required is a reasonable approximation.

> "Furthermore, this court has long realized the practical impossibility of a state's achieving a perfect apportionment of expansive, complex business activities such as those of appellant, and has declared that 'rough approximation rather than precision' is sufficient. *Illinois Central Ry. Co. v. State of Minnesota,* 309 U. S. 157, 161, 60 S. Ct. 419, 422, 84 L. Ed. 670. Unless a palpably disproportionate result comes from an apportionment, a result which makes it patent that the tax is levied upon interstate commerce rather than upon an interstate privilege, this court has not been willing to nullify honest state efforts to make apportionments." *International Harvester Co. v. Evatt,* 329 U. S. 416, 67 S. Ct. 444, 91 L. Ed. 390, reh. den., 329 U. S. 834, 67 S. Ct. 628, 91 L. Ed. 706.

We have not found a case that supports the corporation's contention that the application of three factor formula unreasonably apportions income, nor has one been called to our attention. The formula has however been considered and approved as a reasonable basis for apportioning income. The Supreme Court of the United States, in the case of *Butler Bros. v. McColgan, supra,* held that:

> "We cannot say that property, payroll, and sales are inappropriate ingredients of an apportionment formula. We agree with the Supreme Court of California that these factors **may properly be deemed to reflect 'the relative contribution of the activities in the various states to the production of the total unitary income,'** so as to allocate to California its just proportion of the profits earned by the appellant from this unitary business." (Emphasis added.)

The Appellant imports or purchases raw materials consisting of greige goods, that are converted into salable products, slip covers, draperies and upholstery fabrics by independent contractors at three plants; one at Allen, Massachusetts; one at Gaffney, South Carolina, and the other at Cherokee, North Carolina. Some of the raw material acquired by the Appellant is imported through the Port of Charleston, and some is purchased directly from

South Carolina sellers; however, the amount of the same is not found in the record. The Appellant's executive offices are located in New York City, and it is at this office that the design, pattern and color scheme for the salable products are set. The three independent contractors finish the raw materials in accordance therewith, and the salable products are shipped to the Appellant's warehouse located at McColl, South Carolina. Ten salesmen call upon corporate customers in forty-nine (49) states, and when an order is given it is forwarded to the New York office and, if accepted, a packing order is prepared and sent to the warehouse at McColl. When the packing order is received in McColl, it is there filled and thereafter delivered to a common carrier for shipment to the purchaser. The billing and collecting for the sale is from the New York office, and the Appellant has sales offices in New York, Illinois and California.

It is conceded that the business is unitary in nature, therefore its income is attributable to all incidents of the business and not to any single activity.

> "That term (unitary) is simply descriptive, and primarily means that the concern to which it is applied is carrying on one kind of business—a business the component parts of which are too closely connected and necessary to each other to justify division or separate consideration, as independent units." *State Ex Rel. Maxwell v. Kent Coffey Manufacturing Co., supra.* See also Words & Phrases, Vol. 43, p. 499, Unitary Business.

During the tax periods involved, approximately seventy (70%) percent of the Appellant's property and seventeen (17%) percent of its payroll were in this State. After allocating the sales shipped into states where the Appellant was not subject to taxation to this State, approximately 55.5% of its income was apportioned to this State, while of its total income only 83% was subject to taxation by all states.

We cannot conclude from the record before us that the allocation of approximately 55.5% of the Appellant's

income to this State is unreasonable and unrelated to business done in this State. The Appellant relies upon the case of *Hans Rees' Sons v. State of North Carolina,* 283 U. S. 123, 51 S. Ct. 385, 75 L. Ed. 879; however, it is not here controlling. We do not find where the corporation has made any effort to break up its business into separate or component elements as was done in that case.

The activities of the Appellant in this State constitute a substantial part of the unitary business and the application of the three factor formula does not produce a result that is in conflict with the constitutional provisions referred to, nor does the application of the formula depart from the requirements of Section 65-222.2 of the Code.

The exceptions of the Appellant are overruled, and the judgment below is,

Affirmed.

LEWIS, BUSSEY, LITTLEJOHN and NESS, JJ., concur.

APPENDIX B

STATE OF SOUTH CAROLINA,
COUNTY OF RICHLAND.

COVINGTON FABRICS CORP., PLAINTIFF,

versus

SOUTH CAROLINA TAX COMMISSION, DEFENDANT

IN THE COURT OF COMMON PLEAS

ORDER

This matter, which involves a suit pursuant to Sections 65-2661 and 65-2662 of the Code for the refund of corporate income taxes and license fees, has been brought before me on exceptions to the report of the Honorable Owens T. Cobb, Jr., Master in Equity for Richland County, which report concludes that the taxes were properly assessed and that no refund should be ordered.

The controversy concerns the result reached by the application of the South Carolina income tax apportionment formula contained in Sections 65-279.3 through 65-279.6 of the Code; more specifically, the result reached by applying Section 65-279.6 which contains the sales factor of the formula. (This formula is also used in apportioning the corporation license fee.) In paragraphs 14 and 15 of the Complaint, the Plaintiff has alleged that the Defendant applied the apportionment formula and that its application produced an "unreasonable tax result". The Plaintiff further alleged in paragraph 16 that the result reached by the application of the formula is in violation of Code Section 65-222.2 and violates both the State and Federal Constitutions. The Master found, after a consideration of the evidence and arguments presented to him, that the result reached by the application of the apportionment formula did not conflict with the provisions of Section 65-222.2 of the Code, nor did it violate the provisions of the State or Federal Constitutions.

The Plaintiff has filed thirty-four (34) exceptions, each of which has been considered. It would serve no useful purpose to discuss the merits of each exception separately. The Plaintiff itself has not so argued them to me. Exceptions 1, 2, 3 and 8 allege error by the Master in failing to make certain fact findings; however, ample fact findings were made by the Master which support his conclusions and I, therefore, find these exceptions to be without merit. Exceptions 7, 9, 10, 12, 14, 15, 16, 17, 18 and 20 relate to the question of whether the result reached by the literal application of the apportionment formula is in violation of the requirements of Section 65-222.2 of the Code which imposes the corporation income tax. The additional assessment in question arose from the inclusion of certain of the Plaintiff's sales in the sales factor of the apportionment formula. These were sales in which shipment was made from McColl, South Carolina, to purchasers located in other states. The Plaintiff has not contended, and does not now contend, that the Tax Commission did not apply the provisions of the apportionment formula contained in Sections 65-279.3 through 65-279.6 of the Code. Instead, the Plaintiff contends that the Commission should not have followed the literal language contained in those Sections;

more specifically, Section 65-279.6 which contains the sales factor of the formula, because in doing so it violated the provisions of Section 65-222.2 of the Code.

Section 65-222.2 states that if a taxpayer is transacting business partly within and partly without this State, the income tax shall be "imposed upon a base which reasonably represents the proportion of the trade or business carried on within this State". The Master held that the result reached by the application of the apportionment formula produced a "reasonable" result within the meaning of Section 65-222.2 of the Code and that Section 65-222.2 is not inconsistent with the apportionment formula. I am in agreement with these findings and adopt them for the reasons stated in his report. I do not agree with the position of the Plaintiff that because of the provisions of Section 65-222.2 the Tax Commission had a duty not to literally apply the provisions of the sales factor of the apportionment formula. On the contrary, the Commission had a duty to apply the formula. The alternative of applying the formula only when the Tax Commission believed the results reached to be "reasonable" is clearly untenable. Such action would result in the formula being applied to some multistate businesses but not others and create discretionary authority in an administrative body where the General Assembly obviously intended none to exist. The Plaintiff has relied on the case of *Colonial Life and Accident Insurance Co. v. S. C. Tax Commission,* 248 S. C. 334, 149 S. E. (2d) 777. There the taxpayer had, in arriving at its South Carolina income, deducted all taxes paid by it in this State. The Tax Commission had denied a portion of this deduction on the basis that certain taxes paid by Colonial in South Carolina were for the benefit of its business operations in other states as well as here. The Court upheld this apportionment of the deduction and stated that Section 65-222.2 gave the Commission the power to prescribe a method of apportionment. There was no specific method of apportionment of the deduction provided by statute. The decision stands for the proposition that where a method of apportionment is not provided by statute, the Tax Commission can adopt a reasonable method by regulation or administrative construction. The decision does not stand for the proposition advanced by the Plaintiff that the Tax Commission need not follow the precise language of the apportionment formula. Any administrative construction or regulation which differed from the statutory mandate of the formula contained in Sections 65-279.3 through 65-279.6 would be void. There is room for administrative interpretation only in the absence of precise legislative directive. See 2 Am. Jur. (2d), *Administrative Law,* Section 248.

As the Master noted, the Legislature has prescribed the method in the apportionment formula of arriving at the portion of the Plaintiff's business which is taxable in this State. He found, and I concur in his finding, that the Plaintiff has substantial activities in this State. It is not the proper function of the courts to enter into a precise calculation of what percentage of the taxpayer's income is to be allocated to this State. It is, however, the proper function of the judiciary to determine whether the method of taxation prescribed by the Legislature violates some provision of either the South Carolina or the United States Constitutions. The Master found that the application of the apportionment formula in this case was not shown to produce an unconstitutional result, and I affirm this holding to which exceptions 19, 21, 22, 23, 24, 25, 26, 27, 28 and 33 have been taken. The Plaintiff operates a unitary business. Its activities in this State both contribute to and are dependent upon the operation of the business outside this State. The United States Supreme Court has recognized the unitary business concept in taxation at least as early as 1897 in the case of *Adams Express Co. v. Ohio,* 165 U. S. 194, 17 S. Ct. 305. The warehousing function of the Plaintiff in South Carolina unquestionably contributes to its over-all profit which is derived from sales to purchasers located in nearly every state in the Country. Contrary to the contention of the Plaintiff, as expressed in exception 7, the record supports the Master's finding that the Plaintiff has substantial contacts with South Carolina other than its centralized warehousing function which is wholly located here. It purchases unfinished goods from sellers lo-

cated in this State and imports a large portion of its raw material through Charleston. The Plaintiff contracts with South Carolina finishing plants for the conversion of these goods.

The question of the constitutionality of the result reached under an apportionment formula has been before the United States Supreme Court on many occasions. The formulas used in these cases are almost as numerous as the cases themselves. The use of the sophisticated three-factor formula, which is employed by South Carolina, has been specifically sanctioned by the Supreme Court in the case of *Butler Brothers v. McColgan,* 315 U. S. 501, 62 S. Ct. 701 (1942). The Master was correct in quoting the following language from the case of *State of Wisconsin v. J. C. Penney Co.,* 311 U. S. 435, 61 S. Ct. 246, in determining whether the application of the formula violates the Due Process Clause of the Federal or State Constitutions:

> "* * *. That test is whether property was taken without due process of law, or, if paraphrase we must, whether the taxing power exerted by the state bears fiscal relation to protection, opportunities, and benefits given by the state. The simple but controlling question is whether the state has given anything for which it can ask return. * * *."

That rule was strongly affirmed in *Northwestern States Portland Cement Company v. Minnesota,* 358 U. S. 450, 79 S. Ct. 357, a case which involved the constitutionality of an income tax. The apportionment formula has produced a result which attributes slightly more than half of the Plaintiff's total income to South Carolina. It is true that the Plaintiff, in the case at hand, has substantial activities in New York City; however, the record fails to disclose that any state has given more protection to the Plaintiff's business activities than South Carolina. With the exception of some sample merchandise, the Plaintiff's goods were never in New York during either the conversion process or during storage as finished products. The Plaintiff does no manufacturing and warehousing is an important part of its business. After a complete review of the

evidence, I find, as the Master found, that the Plaintiff's activities in this State are sufficient to support the tax levied. As stated in the *J. C. Penney* case, this State has exerted its power in relation to opportunities which it has given, to the protection which it has afforded and to the benefits which it has conferred.

The Plaintiff has attempted to show that the result reached under the apportionment formula has worked a burden on interstate commerce. It has relied heavily on the case of *Hans Rees' Sons v. State of North Carolina,* 283 U. S. 123, 51 S. Ct. 385, to show that extraterritorial values have been taxed. In that case the taxpayer demonstrated by a species of separate accounting that income arising from activities within the taxing state was grossly less than that attributed by the primitive single factor formula then employed by North Carolina. The Master found and I affirm his finding that no such showing has been made here. The *Hans Rees* case and its sequel, *Maxwell v. Kent-Coffey Manufacturing Co.,* 204 N. C. 365, 168 S. E. 397, affirmed *per curiam* 291 U. S. 642, 54 S. Ct. 437, are discussed at length in the South Carolina case of *Mercury Motor Express, Inc. v. South Carolina Tax Commission,* 244 S. C. 134, 135 S. E. (2d) 756. The *Kent-Coffey* decision as well as the *Butler Brothers* decision, *supra,* severely restrict the *Hans Rees* rationale and require clear and cogent evidence to impeach, on constitutional grounds, the result reached by an apportionment formula.

The Plaintiff argued to the Master that the South Carolina apportionment formula subjected it to the risks of multiple taxation. It has not pressed this point to me, and it is sufficient to state that the Master was correct in holding that it is not the risk of multiple taxation, but the fact of multiple taxation which must be shown in order to prove that interstate commerce has been burdened.

At the conclusion of the reference, the Defendant, Tax Commission, moved to strike an amendment to the Complaint. The Plaintiff had amended paragraph six of the Complaint to read: "No sales are consummated except in New York **or some other state except South Carolina where sales to customers are slightly over 1% of total sales.**"

Whether the Plaintiff should have been allowed to add the underscored language to the pleadings was discretionary with the Master. Although it appears that the Defendant has abandoned its motion to strike the amendment, in the interest of clarity, the Defendant's motion is specifically denied. The Master held that the question of where sales are consummated is not controlling here. I adopt that holding which is directly supported by the language quoted by him from the recent South Carolina case of *United States Steel Corporation v. South Carolina Tax Commission,* 259 S. C. 153, 191 S. E. (2d) 9.

I, therefore, affirm the Master's holdings that the result reached under the apportionment formula does not conflict with Section 65-222.2 of the Code and that the result does not conflict with the provisions of either the South Carolina or the United States Constitutions. For the foregoing reasons, I am of the opinion that the Complaint in this action should be dismissed, and

IT IS SO ORDERED.

/s/ JOHN GRIMBALL,
Resident Judge,
Fifth Judicial Circuit.

Columbia, South Carolina
January 12th, 1974

APPENDIX C

MASTER'S REPORT: (C. A. No. 4894)

Columbia, S. C., April 23, 1973

To the Presiding Judge of the Court of Common Pleas for Richland County, South Carolina:

I, the undersigned Master, report that pursuant to the Order of Reference granted in the above-entitled case, two references were held, attended by the attorneys of record, the testimony was taken, which is herewith reported, and from the testimony and evidence presented I find and conclude as follows:

1. This is an action brought pursuant to Sections 65-2661 and 65-2662 of the South Carolina Code of Laws for

the recovery of corporation income taxes and corporation license fees and interest paid by the Plaintiff under protest to the Defendant in the amount of $36,708.10, together with appropriate interest from the date of payment.

2. The Plaintiff, Covington Fabrics, Inc. (hereinafter Covington), is a New York corporation authorized to do business and doing business in South Carolina under the authority of the South Carolina Business Corporation Act. The Plaintiff is a converter of unfinished textile goods. Its principal activities consist of (1) the purchase of unfinished goods, (2) the styling of the goods, (3) the conversion of these goods through independent contractors, (4) the warehousing of the finished goods and, (5) the marketing of the finished goods. A portion of the raw materials are purchased in the United States from wholesalers, some of whom are located in South Carolina, and a portion is purchased overseas and imported through ports in New York City; Norfolk, Virginia and Charleston, South Carolina. The raw materials are first sent to Georgia for cleaning and are then shipped primarily to one of two South Carolina finishing plants for conversion into slipcovers, draperies and upholstery fabrics. The finished goods are then brought to McColl, South Carolina, where Covington maintains a centralized warehousing operation. All of the Plaintiff's finished goods inventory (except samples) are stored at McColl. The executive and administrative sales offices of the Plaintiff are housed in New York City where styles and patterns are designed. The Plaintiff maintains sales offices in Los Angeles and Chicago. Covington employs a sales force of ten (10) salesmen who operate over an area of forty-nine (49) states. Although invoicing and billing is routed through the New York City office, shipments are made from McColl directly to customers who are located throughout the United States. In brief, the Plaintiff engaged in a multistate business which is unitary in nature.

3. The controversy in this action involves the application of the sales factor of the South Carolina income tax apportionment formula. The apportionment formula is used for both corporation income tax and corporation license fee purposes. The formula allocates a portion of the

entire net income (capital stock in the case of the license fee) of certain multistate businesses to this State based on a three-factor average. It is contained in Sections 65-279.3, 65-279.4, 65-279.5 and 65-279.6 of the Code. The three factors used in the apportionment are property, payroll and sales. The Plaintiff has alleged that the application to it of the apportionment formula, more particularly the application of the sales factor, has produced an unreasonable tax result and, as applied to it, is unconstitutional in that it violates both the Commerce Clause of the United States Constitution and the Due Process Clauses of both the South Carolina Constitution and the United States Constitution. The sales factor is contained in Section 65-279.6 of the Code and is determined by the ratio of sales made by the taxpayer during the income tax year which are attributable to this State to the total sales made by the taxpayer everywhere. The questions to be decided in this case are whether the Defendant properly applied the sales factor of the apportionment formula by attributing certain sales to this State and, if the sales factor was correctly applied, did it produce an unconstitutional result.

4. I find that the Defendant, by including sales in which shipment was made from within this State directly to purchasers located in states where the Plaintiff was not taxable, has properly applied the sales factor of the South Carolina apportionment formula. The parties are in agreement that sales should be attributed to this State for the purpose of inclusion in the sales factor of the apportionment formula when the purchaser of the goods is in this State. This is a so-called destination sale. The controversy has arisen from the attribution to South Carolina of certain origin sales; that is, sales in which the goods are shipped from the McColl warehouse to purchasers located in certain other states.

The sales factor provides for the inclusion of destination sales. It also provides for the inclusion of origin sales "when the property is shipped from within this State and the purchaser is the United States Government or **the taxpayer is not taxable in the state of the purchaser.**" From the testimony it is clear that for the sales in controversy,

shipment of the goods was made from within this State. It is therefore necessary to determine whether or not the Plaintiff was taxable in certain states into which the goods were shipped; that is, the state of the purchaser. A state's power to tax interstate business is a question to be determined under Federal law. In its interpretation of the United States Constitution, the Supreme Court has defined certain minimum contacts with a state which must exist before a state can acquire jurisdiction to tax. See *Northwestern States Portland Cement Company v. Minnesota*, 358 U. S. 450, 79 S. Ct. 357. Minimum standards of activity are now defined in Public Law 86-272, the only federal legislation relating to the subject. See 15 U. S. C. A. Section 381. The record shows that the Plaintiff had only minimal contact with states other than South Carolina, New York, California and Illinois. It is the attribution to this State of sales in which shipments were made from McColl directly to purchasers in states other than these four that is in issue. I find that the Plaintiff has offered no evidence to show that it was **taxable** in any states other than these. The Plaintiff's own expert witness has testified that he "doubted" that the Plaintiff could be subjected to tax in any other states. Instead the Plaintiff has argued that whether or not it can be subjected to tax in other states has no bearing on its tax liability to South Carolina. I disagree with the Plaintiff on this point. I conclude that the sales factor is explicit in defining what sales are attributable to this State. An origin sale must meet two criteria: (1) shipment must be made from within South Carolina and, (2) the taxpayer must not be **taxable** in the state of the purchaser.

Not including South Carolina, the Plaintiff made sales to customers located in forty-eight (48) states. I conclude that with the exception of New York, California and Illinois (which did not have an income tax), the Plaintiff was not taxable in any state into which goods were shipped from South Carolina. I base this conclusion on the lack of activities in these states and the fact that these minimal activities did not give these states sufficient contact with the Plaintiff to subject the Plaintiff to a tax liability.

5. The position of the Plaintiff is that Section 65-222.2 of the Code prohibits the inclusion of the origin sales in the sales factor of the apportionment formula and that the Defendant should not have followed the precise statutory mandate contained in Section 65-279.6. The Plaintiff has relied on the language of Section 65-222.2 which states that the income tax of a multistate business should be "imposed upon a base which reasonably represents the proportion of the trade or business carried on within this state". It contends that the application of the sales factor of the apportionment formula contained in Section 65-279.6 of the Code is inconsistent with the provisions of the imposition section contained in Section 65-222.2. From an examination of the record before me in this reference, I find that the application of the apportionment formula has produced a "reasonable" result within the meaning of Section 65-222.2 of the Code.

Sections 65-222.2 and 65-222.6 of the Code were enacted as parts of the "Act Providing for the Determination, Allocation and Apportionment of Income for Tax Purposes". See Sections 2 and 5(c) of Act No. 731, Acts and Joint Resolutions of 1958 at 1574. These sections relating to the same subject are therefore in *pari materia* and must be construed together. In Section (5) of the 1957 Act, the General Assembly specifically provided a method, by means of the apportionment formula, to arrive at what it must have considered to be a "reasonable" apportionment of income. I do not find these sections, now codified as Sections 65-222.2 and 65-279.4 through 65-279.6, to be inconsistent. My conclusion is supported by the language of the South Carolina Supreme Court in the case of *Hertz Corporation v. South Carolina Tax Commission,* 246 S. C. 92, 142 S. E. (2d) 445 (1965). The court in analyzing the provisions of Act No. 731 stated:

> "The purpose of this legislation, as declared * * * is to provide for the imposition of the South Carolina income tax, where the taxpayer is also subject to income tax in other states 'upon a base which reasonably represents the proportion of the trade of business carried on within this State.'"
> * * *
>
> "The legislature apparently considered that the **three factor formula** would be best calculated to attain the **objective of reasonable allocation of income** where the business of the taxpayer is appropriate to its use, and undertook to classify business accordingly. * * *." (Emphasis added.)

Although I will not substitute my judgment for that of the General Assembly in arriving at what portion of the taxpayer's income should be allocated to South Carolina, it is interesting to note that warehousing is an important part of this taxpayer's business. The Plaintiff does no manufacturing and it contracts for the finishing of its raw materials.

6. I conclude that the South Carolina apportionment formula as applied to the Plaintiff is not unconstitutional and that its application violates neither the Constitution of South Carolina nor the Constitution of the United States.

The Plaintiff has alleged that the tax in question violates the Due Process Clause as a taking without due process of law, and that it violates the Commerce Clause in that it is imposed on interstate business beyond the jurisdiction of this State. In *Wisconsin v. J. C. Penney Co.,* 311 U. S. 435, 61 S. Ct. 246, p. 250 (1940), the Supreme Court stated:

> "* * *. That test is whether property was taken without due process of law, or, if paraphrase we must, whether the taxing power exerted by the state bears fiscal relation to protection, opportunities, and benefits given by the state. The simple but controlling question is whether the state has given anything for which it can ask return. The substantial privilege of carrying on business in Wisconsin, which has here been given, clearly supports the tax, and the state has not given the less merely because it has conditioned the demand of the exaction upon happenings outside its own borders. The fact that a tax is contingent upon events

> brought to pass without a state does not destroy the *nexus* between such a tax and transactions within a state for which the tax is an exaction. * * *."

I find that activities of the Plaintiff in South Carolina are clearly substantial as compared to their over-all operations. I further find that the tax imposed bears fiscal relation to the protection and benefits given by this State. South Carolina has taxed approximately 55% of the Plaintiff's total income. I conclude that the burden is on the Plaintiff to show that the apportionment formula resulted in extraterritorial values being taxed, and the United States Supreme Court has stated that this burden of proof must be met by "clear and cogent evidence". See *Buller Bros. v. McColgan,* 315 U. S. 501, 62 S. Ct. 701 (1942), and *Norfolk and Western Ry. Co. v. North Carolina,* 297 U. S. 682, 56 S. Ct. 625. This burden of proof was met in the case of *Hans Rees' Sons v. State of North Carolina,* 283 U. S. 123, 51 S. Ct. 385, on which the Plaintiff so heavily relies. However, I find that the Plaintiff has not brought itself within the rationale of that case. The South Carolina Supreme Court considered the *Hans Rees'* decision in *Mercury Motor Express, Inc. v. South Carolina Tax Commission,* 244 S. C. 134, 135 S. E. (2d) 756, and Mr. Justice Bussey stated:

> "There (in *Hans Rees'*) the State of North Carolina applied its proportionate property value formula to determine the taxable net income of a manufacturing concern in that state. The taxpayer contended **that it was not engaged in a unitary business;** that its net income derived from activities in North Carolina was determinable without the necessity of resorting to any proportionate formula; and offered evidence of the effect that the portion of its net income attributable to activities in the State of North Carolina was some seventeen per cent, whereas, the application of the formula allocated to the State of North Carolina from sixty-six per cent to eighty-five per cent of the net income of the taxpayer." (Emphasis added.)

I find that the Plaintiff operates a unitary business. I also find that it has not attempted to separately account for the portion of its income derived from South Carolina activities and has introduced little or no evidence breaking its business into component parts. In the case of *Maxwell v. Kent-Coffey Manufacturing Co.,* 204 N. C. 365, 168 S. E. 397, Aff'd *per curiam* 291 U. S. 642, 54 S. Ct. 437, relied on by our court in *Mercury Motor Express,* the North Carolina Supreme Court stated that in order to meet the criteria of the *Hans Rees'* decision, evidence must be introduced showing the influence of each factor of the business in producing income. No such evidence has been introduced. Based on the evidence presented, I find that the Plaintiff has not met the burden of proof required to show that the South Carolina apportionment formula has allocated an arbitrary or unreasonable amount of its income to this State and I further find that it has not shown that the allocation has taxed extraterritorial values.

In its Brief, the Plaintiff has stated that the South Carolina apportionment formula has subjected it to the risk of multiple taxation. I find that the Plaintiff has offered no evidence that interstate commerce has been burdened by multiple taxation. Instead I find from the evidence presented that for the tax years in question, all states combined did not tax more than 85% of Covington's income. The decisions of the United States Supreme Court hold, and I conclude, that the burden is on the taxpayer to show that it has been actually subjected to multiple taxation. See *General Motors Corporation v. Washington,* 337 U. S. 436 (1964). It is therefore not necessary to pass on the "risk" of multiple taxation. However, it should be noted that the South Carolina apportionment formula corresponds to that contained in the *Uniform Division of Income for Tax Purposes Act,* Section 9, *et seq.,* 9A Uniform Laws Annotated 449, which has been adopted in a number of states. The sales factor contained in the South Carolina apportionment formula is substantially identical to that contained in Section 16 of the Uniform Act. The Uniform Act was, of course, designed to prevent the possibility of double taxation.

A great deal of evidence was presented and arguments were put forth by both Plaintiff and Defendant on the question of where title passed and sales took place. Since that time, the South Carolina Supreme Court handed down the case of *United States Steel Corporation v. South Carolina Tax Commission,* 259 S. C. 153, 191 S. E. (2d) 9. In that case the court said that for the purpose of including sales in the sales factor of the apportionment formula "the technical situs at which a sale is confirmed, controlling for other legal purposes, is irrelevant here". We are concerned here with what sales are attributed to South Carolina for income tax and license fee apportionment purposes. This is not a sales tax and South Carolina has not attempted to tax these sales. I conclude that the question of passage of title is not controlling here.

CONCLUSION

I therefore conclude that the inclusion in the sales factor of the apportionment formula of sales in which shipment was made from within this State directly to purchasers in states where the Plaintiff could not have been subjected to taxation was proper. I further conclude that the attribution of these sales to South Carolina for income tax and license fee apportionment did not violate the provisions of either the South Carolina or United States Constitutions.

Respectfully submitted,

/s/ OWENS T. COBB, JR.,
As Master in Equity for
Richland County.

APPENDIX D

ART. I, § 8 CONSTITUTION OF THE UNITED STATES

§ 8. Powers of Congress.

The Congress shall have power . . .

To regulate commerce with foreign nations, and among the several states, and with the Indian tribes; . . .

And

To make all laws which shall be necessary and proper for carrying into execution the foregoing powers, and all other powers vested by this Constitution in the government of the United States, or in any department or officer thereof.

* * *

APPENDIX E

CONSTITUTION OF THE UNITED STATES

ARTICLE XIV.

§ 1. Citizenship rights not to be abridged by states.

All persons born or naturalized in the United States, and subject to the jurisdiction thereof, are citizens of the United States and of the state wherein they reside. No state shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any state deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

APPENDIX F

Public Law 86-272

15 U. S. C. § 381. Imposition of net income tax—Minimum Standards

(a) No State, or political subdivision thereof, shall have power to impose, for any taxable year ending after September 14, 1959, a net income tax on the income derived within such State by any person from interstate commerce if the only business activities within such State

by or on behalf of such person during such taxable year are either, or both, of the following:

(1) the solicitation of orders by such person, or his representative, in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State; and

(2) the solicitation of orders by such person, or his representative, in such State in the name of or for the benefit of a prospective customer of such person, if orders by such customer to such person to enable such customer to fill orders resulting from such solicitation are orders described in paragraph (1).

Domestic corporations; persons domiciled in or residents of a State

(b) The provisions of subsection (a) of this section shall not apply to the imposition of a net income tax by any State, or political subdivision thereof, with respect to—

(1) any corporation which is incorporated under the laws of such State; or

(2) any individual who, under the laws of such State, is domiciled in, or a resident of, such State.

Sales or solicitation of orders for sales by independent contractors

(c) For purposes of subsection (a) of this section, a person shall not be considered to have engaged in business activities within a State during any taxable year merely by reason of sales in such State, or the solicitation of orders for sales in such State, of tangible personal property on behalf of such person by one or more independent contractors, or by reason of the maintenance, of an office in such State by one or more independent contractors whose activities on behalf of such person in such State consist solely of making sales, or soliciting orders for sales, of tangible personal property.

Definitions

(d) For purposes of this section—

(1) the term "independent contractor" means a commission agent, broker, or other independent contractor who is engaged in selling, or solicting orders for the sale of, tangible personal property for more than one principal and who holds himself out as such in the regular course of his business activities; and

(2) the term "representative" does not include an independent contractor.

Pub. L. 86-272, Title I, § 101, Sept. 14, 1959, 73 Stat. 555.

§ 382. Assessment of net income taxes; limitation; collection

(a) No State, or political subdivision thereof, shall have power to assess, after September 14, 1959, any net income tax which was imposed by such State or political subdivision, as the case may be, for any taxable year ending on or before such date, on the income derived within such State by any person from interstate commerce, if the imposition of such tax for a taxable year ending after such date is prohibited by section 381 of this title.

(b) The provisions of subsection (a) of this section shall not be construed—

(1) to invalidate the collection, on or before September 14, 1959, of any net income tax imposed for a taxable year ending on or before such date, or

(2) to prohibit the collection, after September 14, 1959, of any net income tax which was assessed on or before such date for a taxable year ending on or before such date.

§ 383. Definition

For purposes of this chapter, the term "net income tax" means any tax imposed on, or measured by, net income.

§ 384. Separability provision

If any provision of this chapter or the application of such provision to any person or circumstance is held invalid, the remainder of this chapter or the application of

such provision to persons or circumstances other than those to which it is held invalid, shall not be affected thereby.

* * *

APPENDIX G

South Carolina Code of Laws (1962)

§ 65-222. **Tax on corporations.**—Every corporation organized under the laws of this State, whose entire business is transacted or conducted within this State, shall make a return and shall pay annually an income tax equivalent to five per cent of the entire net income received by such corporation during the income tax year, and except as otherwise provided, every corporation organized under the laws of this State, doing or transacting business partly within and partly without this State, shall make a return and shall pay annually an income tax equivalent to five per cent of proportion of its entire net income, to be determined as provided in this chapter, and except as otherwise provided, every foreign corporation transacting, conducting, doing business or having an income within the jurisdiction of this State, whether or not such corporation be engaged in or the income derived from intrastate, interstate, or foreign commerce, shall make a return and shall pay annually an income tax equivalent to five per cent of a proportion of its entire net income, to be determined as provided in this chapter. The terms "*transacting,*" "*conducting,*" or "*doing business,*" as used in this section shall include the engaging in or the transacting of any activity in this State for the purpose of financial profit or gain.

* * *

§ 65-222.2. **Tax on businesses conducted partly within and partly without the State.**—If any taxpayer, except those defined in § 65-256, is transacting or conducting his business partly within and partly without this State, the income tax as provided in this chapter shall be imposed upon a base which reasonably represents the proportion of the trade or business carried on within this State. The taxpayer subject to taxation under this section shall be deemed to have been transacting or conducting his business

partly within and partly without the State if such taxpayer is subject to a net income tax or a franchise tax measured by net income in any other state, the District of Columbia, a territory or possession of the United States, or any foreign country, or would be subject to the net income tax in any other such taxing jurisdiction if such other taxing jurisdiction adopted the net income tax laws of this State. *Provided,* that nothing herein shall operate to deny any taxpayer affected by this section and §§ 65-222, 65-222.1, and 65-279 to 65-279.11 the benefits of § 65-259 (12) where such taxpayer suffers a net loss, but as to the apportionment of net operating losses carried forward, the provisions of those sections apply as if the taxpayer had a net income. (1958 (50) 1574; 1959 (51) 363.)

* * *

§ 65-279.6. **Same; ratio for sales.**—The ratio of sales made by such taxpayer during the income year which are attributable to this State to the total sales made by such taxpayer everywhere during the income year, and for purposes of this article, sales attributable to this State shall be all sales where the goods, merchandise, or property is received in this State by a purchaser, other than the United States Government. In the case of delivery of goods by common carrier, or by other means of transportation, including transportation by the purchaser, the place at which the goods are ultimately received after all transportation has been completed shall be considered as the place at which the goods are received by the purchaser. Direct delivery into this State by the taxpayer to a person or firm designated by a purchaser from within or without the State shall constitute delivery to the purchaser in this State. Sales are attributable to this State when the property is shipped from within this State and the purchaser is the United States Government or the taxpayer is not taxable in the state of the purchaser. The word "*sales*" as used in this article shall be construed to include rentals of tangible personal property the rentals from which are not separately allocated under this article. Such rentals to be attributed to this State if the property is located in this State. Sales of intangible personal property shall be

attributable to this State if the entire income producing activity is within this State, or based on costs of performance the greater proportion thereof is performed within this State. (1958 (50 1574; 1959 (51) 363.)

• • •

§ 65-602. **Annual reports to be filed by corporations and cooperatives; exemption of cooperatives from tax.**—Every corporation organized under the laws of South Carolina to do business for profit and every corporation organized to do business under the laws of any other state, territory or country and qualified to do business in South Carolina and any other corporation required by § 65-222 to file income tax returns shall, in addition to any and all other requirements of law, make a report annually to the Tax Commission on or before the fifteenth day of the third month next after the preceding income year in such form as may be prescribed by the Tax Commission containing such information and facts as the Commission may require for the administration of the provisions of this chapter.

Cooperative organizations and corporations organized under chapters 14, 15 or 16 of Title 12 shall file reports required by this section, but shall be exempt from the tax levied in § 65-606.

• • •

§ 65-606. **License tax imposed on corporations generally; rate; when payable.**—In addition to any and all other license taxes or fees or taxes of whatever kind, every corporation required to file a report by § 65-602, except such corporations as are enumerated in § 65-608, shall pay to the Commission, at the time of filing the report required by § 65-602, an annual license fee of one mill upon each dollar paid to the capital stock and paid in as surplus of said corporation as shown by the records of the corporation on the first day of the income year next preceding the date of filing the report. In no case shall the license fee provided for by this section be less than ten dollars. The license fee provided for by this section shall be paid at the time of filing the report pursuant to the provisions of

§ 65-602, on or before the fifteenth day of the third month next after the preceding income year.

• • •

APPENDIX H

NOTICE OF APPEAL TO THE SUPREME COURT OF THE UNITED STATES

Notice is hereby given that Covington Fabrics Corp., Appellant above named, hereby appeals to the Supreme Court of the United States from the final judgment of the Supreme Court of the State of South Carolina, by Opinion No. 19968, filed March 10, 1975.

This appeal is taken pursuant to 28 U. S. C. 1257 (2).

JAMES M. WINDHAM,
Counsel for Appellant.

May 16, 1975

CERTIFICATE OF SERVICE

I hereby certify that service of the foregoing notice of appeal has been mailed, postage prepaid, to John C. von Lehe, Esquire, Assistant Attorney General, South Carolina Tax Commission, P. O. Box 125, Columbia, South Carolina, Counsel for Appellee, this 16th day of May, 1975. I further certify that all parties required to be served have been served.

JAMES M. WINDHAM,
Counsel for Appellant.

Supreme Court, U. S.
FILED
JUN 25 1975

Supreme Court of the United States

OCTOBER TERM, 1974

No. 74-1521

COVINGTON FABRICS CORP., APPELLANT,

versus

SOUTH CAROLINA TAX COMMISSION, APPELLEE

ON APPEAL FROM THE SOUTH CAROLINA SUPREME COURT

MOTION TO DISMISS

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Supreme Court of the United States

OCTOBER TERM, 1974

No. 74-1521

COVINGTON FABRICS CORP., APPELLANT,

versus

SOUTH CAROLINA TAX COMMISSION, APPELLEE

ON APPEAL FROM THE SOUTH CAROLINA SUPREME COURT

MOTION TO DISMISS

The Appellee, pursuant to Rule 16 of the Rules of the Supreme Court of the United States, moves the Court to dismiss the Appeal herein on the grounds (1) that the Appeal does not present a substantial federal question, (2) that the judgment sought to be appealed rests on an adequate nonfederal basis, and (3) that no federal question is presented which has not been previously decided by this Court.

I

THE STATE STATUTES INVOLVED AND THE NATURE OF THE CASE

A. The Statutes

The South Carolina statutes to be considered are Section 65-222.2 of the Code which imposes an apportioned income tax on businesses conducted partly within and partly without South Carolina, Section 65-607 of the Code which imposes an apportioned license tax based on capital stock on businesses conducted partly within and partly without South Carolina and, Sections 65-279.3 through 65-279.6 of the Code which provide a method of apportionment for both income and license tax purposes based on a three-factor formula of property, payroll and sales.

B. The Proceedings Below

This action was brought for the recovery of corporate income taxes and license fees in the Court of Common Pleas, the South Carolina Court of general trial jurisdiction. The Complaint raised two questions; first, that the application of the apportionment formula violated the provisions of Section 65-222.2 of the Code which provides for a reasonable allocation of income and secondly, that the apportionment formula as applied to Covington Fabrics Corp. violated both the Due Process and the Commerce Clauses of the United States Constitution. The Trial Judge referred the matter to a Master for the taking of evidence and instructed him to report his findings of both law and fact. The Master duly reported his findings with the conclusion that the refund should be denied. Exceptions to the Master's Report were taken and heard before the Trial Judge who issued his order in which he affirmed the Master's holdings that the result reached by the apportionment formula did not conflict with Section 65-222.2 of the Code

which requires a reasonable allocation and that the result did not violate the provisions of the United States Constitution. He therefore denied the refund and dismissed the Complaint. Appeal was taken to the South Carolina Supreme Court which affirmed the judgment of the Lower Court. The South Carolina Supreme Court held that the South Carolina taxing statutes as applied were not repugnant to the Constitution of the United States and that the income tax apportionment formula (Sections 65-279.3 through 65-279.6 of the Code) did not produce a result in conflict with Section 65-222.2 of the Code. The Court also stated that Federal Law 86-272 (15 U. S. C. A. 381) requiring certain minimum contacts and activity within a state before its income could be subject to tax was "not relevant" because the evidence did not support the conclusion that Covington Fabrics Corp. was taxable in more than three (3) states.

II

ARGUMENT

A.

The validity of the South Carolina taxing statutes cannot be drawn in question on the ground that they violate a Federal law, i.e., 15 U. S. C. A. 381, because no rights granted under that law have been adjudicated by the South Carolina Supreme Court.

No right of Covington Fabrics Corp. (hereinafter Covington) granted by a Federal law has even been adjudicated by the State Courts, much less rejected. The provisions of 15 U. S. C. A. 381 deny a state the power to impose an income tax when a taxpayer's activities in that state do not exceed certain minimum standards. There is no question that Covington's activities in South Carolina exceeded the minimum standards set by 15 U. S. C. A. 381

and therefore it cannot claim that any rights guaranteed to it under Federal law have been rejected. The Appeal therefore lacks a substantial Federal question and should be dismissed. *Gordon v. Caldeleugh,* 7 U. S. 268, 269 (3 Cranch), 2 L. Ed. 436, 437. The South Carolina Supreme Court did comment on 15 U. S. C. A. 381 but only in deciding a pure question of State law—the apportionment of income taxes and license fees to South Carolina. So long as the result of this apportionment was in conformity with the United States Supreme Court's interpretation of the Constitution (which will be discussed in Argument B), no reason exists why this Court should consider the correctness of a State judgment which did not adjudicate Federal rights. *Herb v. Pitcairn,* 324 U. S. 117, 125; *Murdock v. Memphis,* 20 Wall 590, 636, 22 L. Ed. 429, 444.

The South Carolina apportionment formula attributes sales to this State when a taxpayer ships goods from South Carolina and the taxpayer is "not taxable in the state to which the goods were shipped". In deciding whether the sales factor of the South Carolina apportionment formula (Section 65-279.6 of the South Carolina Code) had been correctly applied to Covington, the South Carolina Supreme Court found the Federal statute (15 U. S. C. A. 381) **not to be revelant** because the evidence supported the conclusion that Covington was taxable in only three (3) states. In those states, Covington was clearly subject to taxation because of its contacts there. In the other states to which goods were shipped, a factual question existed which, in the opinion of the South Carolina Court, should be decided against the taxpayer. The United States Supreme Court has consistently refused to review findings of fact. *Grayson v. Harriss,* 267 U. S. 352, 358; *Fry Roofing Co. v. Wood,* 344 U. S. 157, 160. At the risk of resurrecting such a factual dispute already decided by the State Court, it must be stated that the record does

not support the statement made on behalf of Covington, at page 10 of its Jurisdictional Statement, that its salesmen were regularly engaged in collecting and servicing delinquent accounts in fifty (50) states. On the contrary, the record supports the conclusion that such activity was not the ordinary function of the salesmen and that collections by them were rare. It should be noted that this sparse collection activity was considered of so little consequence that it was not even mentioned in any of the three State Court decisions handed down in this action, i.e., Master's Report, Circuit Court Decision or the Supreme Court Decision. The United States Supreme Court is **not** here being asked to review a State Court decision which held that regular servicing and collection of accounts were insufficient activities to remove the protections of 15 U. S. C. A. 381. There was no such holding by the Courts of South Carolina.

Even if the South Carolina Supreme Court had held that the word "taxable" as used in that State's apportionment formula meant "actually taxed" rather than "subject to tax", no Federal question would be raised. The South Carolina Court was under no compulsion to even consider 15 U. S. C. A. 381. That statute deals strictly with a state's power to tax, it does not affect its historic right to apportion income as it pleases so long as the method does not offend the United States Constitution. This Court has expressly refused to define any specific method of apportionment. See *General Motors Corporation v. District of Columbia,* 380 U. S. 555, 561. The Georgia Courts have considered and rejected the argument that the jurisdictional limitation set by 15 U. S. C. A. 381 should be used in that State's income tax apportionment statute. See *Hawes v. Bonnell,* 156 S. E. (2d) 536, and the recent case of *Blackmon v. Habersham Mills, Inc.,* 212 S. E. (2d) 337. It is clearly a state's right to do so if it so chooses.

The fact that the South Carolina Court was free to consider or not to consider 15 U. S. C. A. 381 shows that no Federal rights of Covington stemming from that law were adjudicated by the State Court. No State statute has therefore been drawn in question as being repugnant to rights granted by 15 U. S. C. A. 381 and the South Carolina Tax Commission therefore respectfully submits that the United States Supreme Court lacks jurisdiction to take this Appeal or to hear the matter on a Petition for *Certiorari.* In the alternative, the Commission requests that this Court restrain from hearing this matter because no substantial Federal question is involved.

B.

The activities of Covington Fabrics Corp. in South Carolina are substantial and sufficient to support the tax in question. No Federal question based on the Due Process Clause or the Commerce Clause of the United States Constitution is presented which has not been previously decided by this Court.

Challenges made in the United States Supreme Court to a state's apportionment of income taxes and license fees on the ground that the apportionment is repugnant to the Due Process Clause and the Commerce Clause of the United States Constitution have been numerous, however, this Court has consistently upheld the apportioned taxes and has stated that the only question with which it is concerned is "whether the state has given anything for which it can ask return". *State of Wisconsin v. J. C. Penney Co.,* 311 U. S. 435. Covington is a unitary business engaged in converting unfinished "greige" textile goods into finished products and selling them throughout the United States. It does no manufacturing and processing or finishing of its products is contracted to independent finishing plants. The activities of Covington in South Carolina are both numerous and substantial. These consist of (1) domestication, (2) importation through the port of Charleston, (3) purchasing unfinished goods from South Carolina wholesalers, (4) contracting with a finishing plant located in South Carolina for the conversion of unfinished goods into finished products and, (5) the operation at McColl, South Carolina, of a centralized warehouse in which it employs between thirty (30) and forty (40) persons and in which Covington stores all of its finished goods inventory.

South Carolina employs the so-called Massachusetts, three-factor, apportionment formula which is based on the average of property, payroll and sales attributable to South Carolina to property, payroll and sales everywhere. A search has revealed no case in which the United States Supreme Court has held the result reached under such a formula to be unconstitutional. A brief review of the United States Supreme Court's prior decisions on the constitutionality of apportionment formulas is convincing that the questions now raised by Covington have been answered by those prior decisions which were followed by the South Carolina Supreme Court in upholding the tax in question. In *Underwood Typewriter Co. v. Chamberlain,* 254 U. S. 113 (1920), this Court upheld an apportionment which allocated 47% of the taxpayer's net income to Connecticut although the taxpayer showed that $1,300,000.00 of its net profits were received in other states and only about $43,-000.00 in Connecticut. This Court sustained an apportionment in *Bass, Ratcliff & Gretton, Ltd. v. State Tax Commission,* 266 U. S. 271 (1924), which involved a company engaged in brewing ale in England and selling both in that country and the United States. The company contended that the New York Tax Commission was attempting to assign income derived from its operations outside the

United States when it actually operated at a loss in New York. A tax based on $27,537.68 income was sustained on the basis that in-state activities, contributing to the overall unitary income, were sufficient. In *Maxwell v. Kent-Coffey Mfg. Co.,* 168 S. E. 397, North Carolina apportioned 99.2% of the entire net income although the taxpayer established that only .002% of its total sales were "made" within that state. The decision was affirmed by this Court at 291 U. S. 642 (1933), citing the *Underwood Typewriter* case. In *Butler Bros. v. McColgan,* 315 U. S. 501 (1942), the California taxpayer had shown a loss there of $82,851.00; however, this Court upheld a tax based on a profit of $1,149,677.00. Even though accepting Butler Brothers' figures, the Court stated:

> "We agree with the Supreme Court of California that these factors [property, payroll and sales] may properly be deemed to reflect 'the relative contribution of the activities in the various states to the production of unitary income', so as to allocate to California its just proportion of the profits earned by appellant from this unitary business."

Because Covington admittedly operates a unitary business and therefore has made no attempt to separately account for its activities in South Carolina, the case of *Hans Rees' Sons, Inc. v. North Carolina,* 283 U. S. 123, the only decision of this Court disapproving of a result reached by an apportionment formula and reversing a State Court decision not to consider evidence relating to separate accounting, is not in issue.

The South Carolina apportionment formula has allocated slightly more than half of Covington's income to South Carolina. This Court has consistently held that precision in apportionment is not required and that a rough approximation is sufficient. *Illinois Central Ry. Co. v. Minnesota,* 309 U. S. 157, 161. New York and California also

levied taxes on its income, however, during the years in question Covington was taxed on only 84% of its income by all states combined. Far from having a complaint that a multiple burden has been placed on it, this taxpayer has not even been taxed on 100% of its income.

It is apparently the sales factor of the South Carolina apportionment formula which Covington believes has burdened it in a constitutional sense. These are sales attributed to South Carolina when shipments were made from South Carolina to other states where the purchasers of the goods were located. However, prior decisions of this Court have held that in the absence of a showing that these sales were used in apportioning income to the state of the purchaser, and it is undisputed here that they were not, there can be no suggestion that interstate commerce has been burdened. See *General Motors Corporation v. Washington,* 377 U. S. 436, citing *Northwestern States Portland Cement Co. v. Minnesota,* 358 U. S. 450. Because no constitutional question is presented which has not been previously decided by the United States Supreme Court, the South Carolina Tax Commission respectfully submits that this Appeal should be dismissed and this Court should decline to review the South Carolina Supreme Court decision which is in conformity with and based on prior decisions of this Court.

CONCLUSION

C.

South Carolina Tax Commission respectfully submits that the appeal herein should be dismissed on the grounds that the judgment of the Supreme Court of South Carolina rests on an adequate, nonfederal basis and that the questions for which review is sought are so unsubstantial as not to need further argument.

DANIEL R. McLEOD,
JOHN C. von LEHE,
JOE L. ALLEN, JR.,
G. LEWIS ARGOE, JR.,
Attorneys for Appellee,
South Carolina Tax Commission.

I hereby acknowledge acceptance of service of Appellee's Motion to Dismiss this .... day of ....., 1975.

JAMES M. WINDHAM,
Counsel for Covington Fabrics Corp.

With the signing of the above acknowledgment of service, I hereby state that all parties required to be served have been served.

JOHN C. von LEHE,
Counsel for South Carolina Tax Commission.

Supreme Court, U. S.
FILED
JUN 26 1975
MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1974

No. 74-1521

COVINGTON FABRICS CORP., APPELLANT,

versus

SOUTH CAROLINA TAX COMMISSION, APPELLEE

ON APPEAL FROM THE SOUTH CAROLINA SUPREME COURT

BRIEF IN OPPOSITION OF MOTION TO DISMISS OR AFFIRM

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BRIEF IN OPPOSITION OF MOTION TO DISMISS OR AFFIRM

Pursuant to Rule 16(d)(4) of this Court, Appellant submits this Brief in opposition to Appellee's motion to dismiss or affirm.

STATEMENT

The Statement in Appellant's Jurisdictional Statement (pp. 4-6) presents a fair and impartial narrative of the facts, reduced in scope to a bare minimum.

In Appellant's Brief, filed with the Supreme Court of South Carolina, there appears a category titled "Undisputed and Uncontradicted Facts." These appear in said Brief at pp. 2-7. Because of the obvious impact and bearing that these facts should and must play and also the importance that must be given to them in the matter of

Appellant's proof of the unconstitutional exaction of taxes from an interstate business, they are reproduced hereinbelow:

UNDISPUTED AND UNCONTRADICTED FACTS

1. Appellant is a New York corporation, is a converter of drapery, slipcovers and upholstery fabrics and, as such imports griege goods (raw materials) from about ten foreign countries, which goods reach the United States at ports of entry located at Norfolk, Virginia, New York City, and Charleston, South Carolina. Appellant contracts, for a fee, with approximately six independent plants to do the finishing work on the raw goods, these plants being located in Adams, Massachusetts, Gaffney, South Carolina and Cherokee, North Carolina, none of which are either owned, operated or controlled by Appellant. Additionally, Appellant also buys some unfinished goods from manufacturers located in several states including South Carolina. (Ff. 93-98, 185.)

2. Appellant's headquarters are in New York City where it occupies three levels of space (approximately 15,000 square feet) at the corner of 29th Street and Fifth Avenue in the building at 267 Fifth Avenue, where, twice each year, Appellant's business operations begin anew with the planning of a line of goods to be offered to its customers. In its New York headquarters, a staff of about eight Designers and Artists plan about 150 patterns a year with 40 to 60 patterns for each seasonal line. This planning involves a selection of woven goods, and determining, designing and adapting the coloring of patterns to be sent to the aforementioned independent contracting finishers and printers to whom Appellant pays a fee for this service. (Ff. 226, 94, 95, 182-185, 98, 97.)

3. When the line is planned in New York, then the griege goods (raw materials) are purchased, consisting of about seven million yards bought from various companies, like J. P. Stevens, Burlington, Graniteville and various others. About four million yards are bought and imported from overseas through the ports at Norfolk, New York City and Charleston, South Carolina. Additionally, about one million yards of goods, already finished in accordance with Appellant's design, are bought direct from plants like Burlington and J. P. Stevens and others. (Ff. 94, 177-180, 185.)

4. All of Appellant's executive, management and administrative personnel are located in its New York headquarters. All orders taken by Appellant's salesmen are sent to New York where they are handled by about fifteen clerks, each of whom, at some point, handles each other. One will add to or reduce inventory entries, as all inventory records are kept solely in New York. Another clerk will make up commission sheets. Others will prepare invoices, prepare packing orders, handle volumes of correspondence, etc. (Ff. 107, 105, 167-173.)

5. A review made in New York headquarters every day of inventories of this business, is of first importance to determine when to add additional goods by having them converted, printed, woven or finished. (F. 170.)

6. No employees outside Appellant's New York Office have any say whatever in the operations or in the completion of the stock or anything that is done in Appellant's converting business. (F. 173.)

7. All billings, advertising programs, purchasing and planning are prepared and done in New York. A Credit Manager and his assistants, all of whom are located in New York, perform credit checks and related work there. (Ff. 166-173.)

8. Appellant itself does no manufacturing anywhere. In addition to its headquarters in New York City, it maintains an office and showroom in Chicago and in Los Angeles. It employs ten commission salesmen who reside in seven different states (none of which is South Carolina), and these ten salesmen call on customers in forty-nine states and Canada. Additionally, an Export Manager, whose headquarters is the New York City location of Appellant, handles,

along with his staff, ten to fifteen foreign representatives, with customers in at least ten foreign countries overseas. (Ff. 107, 102-103, 182-184, 211.)

9. The ten commission salesmen handle no other lines than Appellant's. They cover their complete territory twice each year. The salesman who has South Carolina resides in Greensboro, North Carolina, and he calls on customers in Florida, Alabama, Georgia, North Carolina and South Carolina. He carries ten cases of samples of about 450 designs. His South Carolina customers, the number being so small, require only about two days per season or four days per year in South Carolina, actual sales to South Carolina customers amounting to only slightly over 1% of total sales. (Ff. 205-210, 223, 235-238.)

10. In addition to calling on customers to sell, it is the duty of a salesman of Appellant to call upon customers who are delinquent in their accounts, to service those accounts, and to try to collect them. Otherwise, all payments for goods are made by the purchaser directly to Appellant's New York headquarters. (Ff. 225, 241-244.)

11. Appellant maintains no office of any kind in South Carolina. It has made no capital investment in South Carolina. It does no manufacturing in South Carolina. It owns no manufacturing plant in South Carolina. It has no executive or management personnel in South Carolina. (Ff. 103, 106.)

12. Appellant's customers are retailers and have remained rather steady and constant during the years in controversy. They include Sears Roebuck, J. C. Penney, Montgomery Ward, R. H. Macy and about every jobber in the country including David and Dash in Miami, Roman in New York, Jack H. Pearl on the West Coast, Pearlstine Company in Seattle, Reese B. Davis in Dallas, Richardson in Atlanta, and Groom and David in New York. (Ff. 229, 273-274.)

13. The Appellant only maintains a rented warehouse in South Carolina and nothing else. It is staffed by thirty to forty employees, all of whom are laborers

except a superintendent and two secretaries, all performing solely a warehousing function. (Ff. 109-110, 191-193.)

14. Prior to Appellant's renting the warehouse space at McColl, the printers and finishers, to which Appellant regularly sent its raw goods for that purpose, left the finished goods in cases after their converting work was completed, and they shipped the goods to the buyers. There was no warehouse maintained for shipping at all. It was what is called a "drop shipment operation". Appellant paid the printers and finishers a fee for this service. (Ff. 443-471.)

15. As a part of the processing of its salesmen's orders, the New York headquarters of Appellant prepares and sends to Appellant's rented warehouse at McColl, S. C. packing orders, setting out instructions for the laborers, known as "pullers", who pull goods from warehouse bins according to the pattern, color and quantity (number of pieces) designated on the packing orders made up in New York. The laborers put the assembled goods on dollies that move them to the packing line. There, the laborers wrap the goods in paper or put them in cartons, tied with twine or metal strapping. (Ff. 122-125.)

16. A bill of lading is prepared for each package and is attached when the goods are placed on the shipping platform to be picked up by a common carrier for delivery to the purchaser at his address. Two copies of the bill of lading are delivered to the trucker and two copies are sent to Appellant's New York office by McColl warehouse. Ff. 125-126, 194-198, 233-234.)

17. Ultimately, that is as it turned out, only three states, namely, New York, California and South Carolina either imposed income taxes or corporate license fees upon Appellant for the years involved or made claim for the same. (Ff. 279-281, 477, 45.)

18. During the years involved in this controversy, Appellant carried blanket or omnibus insurance coverage over goods in transit from its McColl, S. C. warehouse to the purchaser in the total amount of

$3,500,000.00 with liability for any single loss limited to $50,000.00. The premium on this policy costs Appellant the sum of $16,000.00. (Ff. 129-150, 158-166.)

19. Respondent admitted that it arrived at the approximate 84% of all sales everywhere as being reasonably attributable to South Carolina by examining Appellant's tax returns to the other two states, California and New York. In so doing Respondent's field agent saw that Appellant had not been taxed on 100% of its income and he believed therefrom that South Carolina would be demanding a reasonable allocation to it by raising the sales factor to approximately 84% of all sales everywhere. (Ff. 499-526, 489-491.)

20. Respondent testified that before its adjustment to the tax returns of Appellant, approximately 29% of Appellant's income was allocated to South Carolina, and that about 57% of Appellant's total income was being allocated to all three states of New York, California and South Carolina. (Ff. 490-491.)

21. It was admitted by Respondent that after it made its reassessment of Appellant's tax liability to South Carolina, the percentage of Appellant's income claimed by South Carolina was about 55.5%. It was further testified by Respondent's sole witness, its field agent, who did not qualify as an expert, that after its reassessment, all states taxed 83% of Appellant's entire income and he laid emphasis on the fact that Appellant had not been taxed on 100% of its income, and because of that he considered that the reassessment he made was reasonable. (Ff. 502-526.)

QUESTIONS PRESENTED

The questions have been impartially and fairly presented in the Jurisdictional Statement (p. 4). There are obviously substantial Federal questions, both constitutional and statutory.

ARGUMENT

I

Introductory

Appellee will likely contend that this appeal should be dismissed, and, as customary in such Motions, will doubtless raise the principle that the decision of the Supreme Court of South Carolina should not be reviewed because it is allegedly based upon an independent, non-federal ground. This principle is found in *Fox Film Corporation v. Kentucky,* 296 U. S. 207, 56 S. Ct. 183. Such an argument is untenable here as the Supreme Court of South Carolina (Jur. Statement, pp. 17-24) based its decision on Federal grounds. Federal law was stated to have been considered by that Court, was cited by that Court, and formed the only basis for its decision.

This appeal involves the **novel** question of the constitutionality of a "throw-back" of the sales factor of a state income three-factor apportionment or allocation provision.

II

Apportionment of interstate income must not exceed that which reasonably relates to extent of business activity of Appellant within taxing state in terms of factual proof.

If indeed the law today is as this Court has uniformly held, that is, that a state cannot constitutionally allocate to itself for purposes of taxation of a unitary or interstate business net income beyond that which reasonably represents the extent of activity of that taxpayer within the taxing state, then, certainly an exaction is neither made reasonable nor constitutional, but to the contrary is made both more unreasonable and unconstitutional when, as here, the allocation was raised by Appellee from the 29% of total net income, voluntarily allocated by Appellant, to 55.5% of the entire net income by claiming and allocating

sales in states that had not taxed but which were, nevertheless, *"taxable"* there. Throughout the history of this particular case, Appellee has openly admitted that the 55.5% which it claimed, was arrived at by including sales made in the state of the purchaser.

III

Supreme Court of South Carolina erred in holding Appellee can tax, as its own, sales in states of the purchasers where proof showed activity in those states exceeded protection afforded by Federal Statute (15 U.S.C. 381, et seq.).

The sales were proven by Appellant to be *"taxable"* in the states of the purchasers. There was not the slightest evidence offered by Appellee to contradict that proof.

Public Law 86-272, 15 U. S. C. 381, is designed to permit those states of the purchasers the right to tax net income, but nevertheless reasonably and constitutionally, if the activities of the taxpayer in those states of the purchasers exceed the bare solicitation of orders in those states. That law (Public Law 86-272, 15 U. S. C. 381) does not specify either that if those states did not, in fact, *"tax"* or that if the taxpayer *"had not been taxed"* in the state of the purchasers, Appellee can then, nevertheless, claim those sales in such states as its own under the guise of an exaction that bears a reasonable relation to the extent of business activity of the taxpayer within South Carolina. Such makes a mockery out of the federal law and the Constitution.

The S. C. Supreme Court, pp. 6-7 of the Jurisdictional Statement, disregarded the evidence and held, contrary to interpretation given to Public Law 86-272, 15 U. S. C. 381, by the highest courts of the several states, (Jurisdictional Statement, p. 8) that "the corporation in these periods was 'taxable' only in three states: New York,

California and South Carolina." The evidence showed that while the Appellant *"had not been taxed"* except by those three states, but at the same time the evidence clearly showed that Appellant was *"taxable"* in the other states of the purchasers on sale made there because its activity therein uniformly exceeded the protection afforded by Public Law 86-272, 15 U. S. C. 381. (Jurisdiction Statement, p. 10.)

IV

South Carolina Supreme Court ignored facts either admitted, undisputed and/or proven as to real minimal activity of Appellant in South Carolina, showing unconstitutional exaction by Appellee.

Apart from the most important interplay of Public Law 86-271, 15 U. S. C. 381, the decisions by this Court dealing with state taxation of net income of a unitary business, beginning with *United States Glue Co. v. Oak Creek,* 247 U. S. 321, 38 S. Ct. 499, and later in *Shaffer v. Carter,* 252 U. S. 37, 40 S. Ct. 221; *Travis v. Yale and Towne Manufacturing Co.,* 252 U. S. 60, 40 S. Ct. 228; *Underwood Typewriter Co. v. Chamberlain,* 254 U. S. 113, 41 S. Ct. 45; *Bass, Ratcliff and Gretton v. State Tax Commission,* 266 U. S. 271, 45 S. Ct. 82; *State, ex rel. Maxwell v. Kent-Coffey Mfg. Co.,* 204 N. C. 365, 168 S. E. 397, aff. 291 U. S. 642, 54 S. Ct. 437 and enunciated in *N W. States Portland Cement Co. v. State of Minn.,* 358 U. S. 450, 79 S. Ct. 357, have uniformly held that a state net income tax is not unconstitutional unless it is not properly apportioned to local activities within the taxing state.

The above stated principle of law, so well established by decisions of this Court, is meaningless if it is to be applied summarily without regard to proven facts and in face of overwhelming undisputed and uncontradicted facts, disclosing an activity of the taxpayer in South Carolina so

minimal that Appellant can abandon that South Carolina minimal activity without any disruption by either again adverting to "drop shipments," requiring no rented warehouse, or by renting a warehouse in a state without an income tax law.

Despite the fact that Appellee will argue in its Motion that there was sufficient activity by Appellant in South Carolina to cause the Appellee to claim 84% of all sales, the proven facts completely disprove this argument inasmuch as the argumnet is one of a principle of law rather than the application of that principle of law enunciated by this Court measured in terms of the proven facts. The proven facts show that applying the principle of law laid down by this Court as a guideline to those facts, the sanctioning by the South Carolina Supreme Court of an apportionment to Appellee of 84% of all sales violates the Commerce Clause of the U. S. Constitution, Article 1, Section 8, and also violates Section 1 of the Fourteenth Amendment to the U. S. Constitution.

Appellant has shown by competent, unbiased, clear and cogent evidence, including that of an independent certified public accountant who qualified as an expert witness and who was not connected with the business, that the apportionment formula as applied to it by Appellee has resulted in extra-territorial values being taxed. The required burden of proof has been met by Appellant.

An unfortunate course or trend came about through the years following the 1934 decision in *State, ex rel. Maxwell v. Kent-Coffey Mfg. Co.,* 204 N. C. 365, 168 S. E. 397, aff. 291 U. S. 642, 54 S. Ct. 437. The decision of the Supreme Court of North Carolina was affirmed. The Supreme Court of North Carolina, in denying taxpayer's attack on the apportionment of income to North Carolina on constitutional grounds, differentiated this case from the earlier decision of *Hans Rees' Sons v. North Carolina,* 283 U. S. 123, 51 S. Ct. 385, where the allocation was declared unconstitutional as applied to that taxpayer. The distinction drawn by the Court was that in *Hans Rees'* the taxpayer was able to separate the business into its separate component parts, whereas in *Kent-Coffey* the taxpayer failed to do so.

It is submitted that if a business is, in fact, unitary, then it is impossible to separate it into component parts for allocation purposes. In fact, this was recognized by the North Carolina Supreme Court and was stated in the *Kent-Coffey* Opinion itself. Thus, *Hans Rees'* was not a unitary business in the first place under the reasoning of the North Carolina Supreme Court.

In view of the complete inability of any corporate taxpayer to break up a purely unitary business into its separate component parts, does that mean that every allocation or apportionment made by a state in asserting a tax on net income is not in violation of either the Commerce clause or the Fourteenth Amendment irrespective of the glaring inequity implicit in such allocation? The trend today is to be faced with a situation where irrespective of the proven minimal activity within a taxing state as compared to activity of the unitary taxpayer everywhere, nevertheless, there follows a finding that the taxpayer, having failed to break up the business into its component parts, the apportionment, however ridiculous, must stand.

It is submitted that there must be a way apart from being able to break up a unitary business into its component parts, which is not even possible in the first instance, whereby a taxpayer can get relief from an unconstitutional assessment of a net income tax. It is submitted that that way is to prove by competent evidence that the formula, as applied to it, produces a result that is not reasonably related to the business activity carried on by the unitary taxpayer in the taxing state. This Appellant has done that

by competent proof. There was no testimony or proof on the part of Appellee that contradicts that proof of Appellant.

Counsel for Appellee freely admitted in oral argument before the Supreme Court of South Carolina that were it not for the renting of the warehouse in South Carolina, it would not have sought to lay claim to taxes. In addition to the free admission by counsel, it is to be remembered that Appellee taxed extra-territorial sales, not local sales, by asserting that sales in states of the purchasers of Appellant's goods were not "*taxable*" there, when, as a matter of proof, the activities of the taxpayer in those states exceeded the mere solicitation of orders therein and were "*taxable*" sales therein as is clearly reflected in highest state court decisions dealing with Public Law 86-272, 15 U. S. C. 381.

CONCLUSION

Rule 16(d)(4) permits Appellant to file Brief in Opposition to Motion to Affirm or Dismiss. However, distribution of Jurisdictional Statement permits no time to Appellant after filing of Appellee's Motion in which to file Brief in Opposition. Therefore, this Brief is printed prior to filing of Appellee's Motion but any asserted basis for such Motion has been anticipated and the Motion is herein shown to be without merit and merely a perfunctory performance on the part of Appellee.

The Motion to Dismiss or Affirm should be denied because of constitutional and federal questions of patent importance under admitted, undisputed and proven facts on the part of Appellant.

Respectfully submitted,

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